


OFFICE OF THE
CITY MANAGER

TO: The Honorable City Council

FROM: L. Kimball Payne, III, City Manager 

SUBJECT: *Proposed FY 2004 Budget*

DATE: February 28, 2003

Introduction

The *Proposed FY 2004 Budget* for the City of Lynchburg is hereby submitted for City Council's consideration. The budget includes the General, Capital, Airport, Water, Sewer, and Solid Waste Management Funds, as well as other minor funds, and totals \$165 million. The proposed budget was developed in an environment characterized by a continuing national recession, the state fiscal crisis, and the special challenges facing older central cities in the Commonwealth. Limited resources and the inevitability of reduced support from the state government allow for little more than maintaining current service levels and attempting to provide modest salary increases for employees. The proposed budget, however, complies with adopted Financial Management Policies and reflects City Council's vision for Lynchburg and its citizens. The *Proposed FY 2004 Budget*, funds essential services, copes with reductions in state support, maintains a healthy fund balance, provides for a two percent (2%) salary increase for City and school employees, covers increased health insurance premiums without further shifting costs to employees, and continues to make investments in the City's infrastructure. It calls for no increase in property taxes but does recommend that the local tobacco tax be increased to support the General Fund. The Water, Sewer and Solid Waste Management enterprise funds require rate increases to balance required expenditures and comply with fiscal policies, while the operating subsidy to the Airport Fund will be reduced.

Budget Development

City department directors took a very conservative approach in preparing their requests for the *Proposed FY 2004 Budget* and are to be commended. They were aware of the limited revenue growth experienced by the City, the loss of nearly \$2 million in state funding during the current biennium, much of which could not be absorbed or adjusted for, and the resistance from the public to tax or fee increases. In many cases, excluding salary and health insurance increases, departmental budget requests reflected a reduction in proposed spending from the current fiscal year.

Reflecting the national recession, revenues from the sales, business license and lodging taxes remain flat, although within projections. The trend for the meals tax, however, is slightly upward, and the construction of new restaurants in the City continues. The biennial reassessment of real property is effective for the upcoming fiscal year and the total assessed value of real estate in the City is expected to increase



approximately six percent (6%), reflecting a modest amount of new construction, increases in market value in some areas, and a better job by the Assessor's Office in establishing and maintaining property records and values. The staff of that office deserve recognition for their efforts during the last year to update and ensure the accuracy of the City's property database.

The state fiscal crisis has had an effect on the City. Reductions made by the Governor in October and December of 2002 reduced state support by approximately \$1.7 million when FY 2004 is compared to the FY 2002 baseline. Reductions have been experienced in HB599 funding, ABC tax revenues, and funding for Constitutional Officers, social services, libraries, the juvenile detention center and the regional jail. Adjustments have been made by eliminating positions, maximizing other funding options such as federal programs or simply doing without. For some activities, however, such as jail funding, there is no option but to make up for the state cuts. As this message is being written, the General Assembly has completed deliberations and has forwarded FY 2004 State Budget amendments to the Governor. Lacking details on the state budget, estimates of state revenues were based only on past history, reductions already experienced, and limited information regarding amendments adopted by the General Assembly.

In the abstract, budget development is guided by two principal sets of guidelines, the Financial Management Policies and priorities adopted by City Council.

Financial Management Policies

City Council first adopted Financial Management Policies in 1999 and has amended and reaffirmed them as appropriate. The policies address such areas as adopting a balanced budget, the appropriate fund balance to maintain, restrictions on its use for recurring operating expenses, debt management and the establishment of contingency reserves to address unexpected circumstances. If followed, sound financial management policies should do the following:

- Contribute significantly to the City's ability to insulate itself from fiscal crisis and economic disruption
- Enhance short-term and long-term financial credit ability by helping to achieve the highest credit and bond ratings possible
- Promote long-term financial stability by establishing clear and consistent guidelines
- Direct attention to the total financial picture of the City rather than single issue areas
- Promote the view of linking long-term financial planning with day to day operations
- Provide the City Council and the citizens a framework for measuring the fiscal impact of government services against established fiscal parameters and guidelines
- Ensure that the organization is sufficiently resourced to perform mandated responsibilities
- Provide a foundation for evaluating financial analysis and condition

The Financial Management Policies are included in the General Budget Information section of the budget document.



City Council's "Few Vital Priorities"

In November 2000, City Council identified priorities upon which City staff should focus its resources. The priorities have been reaffirmed annually at Council retreats and in September of 2002 they were refined as principles that establish a baseline for City policy development and operations. They are as follows:

- A Superior Education Community
- Increased Real Estate Value
- Fiscal Responsibility
- Economic Development
- Excellent Core Services
- Infrastructure (adequacy of building, street, bridges maintenance, repairs, capital improvements)
- Fight Unfunded Mandates

In addition to those principles, Council identified focus areas for the near future. They included:

- Safe Neighborhoods
- Core Services
- Boards and Commissions
- Fiscal Issues
- Community Environment
- Downtown Development and Redevelopment
- Economic Development
- Education
- Families
- Public Safety

The *Proposed FY 2004 Budget* includes funding for a few new initiatives while attempting to maintain current efforts.

Development of the proposed budget continues to be challenged by what appears to be a fundamental dichotomy of modern civics. Citizens have high expectations about the level and quality of government services yet they are unwilling to support tax increases to pay for those services. Not only are local governments expected to provide the core services of public safety, education and transportation but other services that enhance a community's quality of life, such as libraries, parks and recreation, museums, and quick response to customer requests are also desired. At the same time, significant state and federal mandates require additional local dollars for the school system, social services, Constitutional offices, solid waste, water and sewer, corrections and juvenile detention. Finally, in older cities such as Lynchburg, there is a concentrated need for services to many less advantaged residents and a staggering cost to maintain an aging infrastructure of roads, schools, public buildings, and utilities. A national recession and the state fiscal crisis exacerbate all of this.

Budget development and the deliberations that follow allow a community to assess the mix and level of services that it expects its local government to provide balanced against its willingness to pay for them. To those who claim that government is inherently wasteful, prone to uncontrolled growth and characterized by



many opportunities to reduce spending, full participation in the budget process is offered. The services, programs and processes that make up local government are the result of many incremental, individual decisions made by governing bodies and administrators over the years. An annual re-examination of that mix and the elimination of services, programs and processes that are not mandated and that provide little relative value to the community should be a fundamental component of the budget process.

Budget Analysis

The *Proposed FY 2004 Budget* was developed using a modified zero-based process for all departments. The zero-based process requires each department to prepare a budget request that reflects the actual costs of performing its responsibilities as if it was being done for the first time. Merely proposing incremental additions to a previous year's budget is not acceptable. In a zero-based approach, the fact that a dollar was spent the year before is not relevant to a request for that same dollar in the new fiscal year. Each dollar must be justified as supporting the functions and operations of the department.

Again this year, a small group of City staff volunteered to serve as budget analysts. The analysts were assigned particular departments to review and they met with department representatives, examined past spending patterns, questioned assumptions, and made recommendations to the City Manager. Line item detail was scrutinized in the process. Each line item was evaluated with respect to the need or requirement for the proposed expenditure, the anticipated value to be gained by the expenditure, and the reasonableness of the request based on prior years' history. Furthermore, as this was the first budget prepared with the new Chart of Accounts, all expenditures received an additional fresh look to confirm that they were properly categorized.

Balancing the General Fund Budget

A compilation of budget requests, originally including no salary increase for City employees and level funding of the school system, when compared to estimated revenues in the new fiscal year, indicated a gap of approximately \$5.4 million. Fully funding the initial requests received by the Budget Office from General Fund departments would have required a Real Property Tax Rate of \$1.29 rather than the current rate of \$1.11 for each \$100 of assessed value. The process of re-examining assumptions and cutting expenditure requests to produce a balanced budget followed.

Keeping the Financial Management Policies and City Council's focus areas in mind, the following practical priorities were also used to develop the *Proposed FY 2004 Budget*:

- Fund debt service
- Fund mandated programs
- Maintain a fund balance in accordance with fiscal policy
- Preserve employee benefits
- Provide appropriate compensation for City employees
- Fund school construction at a level previously committed to by City Council
- Replace essential equipment, especially vehicles and computers
- Maintain existing facilities



- Provide excellent core services
- Provide quality customer service

The extent to which the proposed budget addresses these priorities, given the limited resources available, will be a matter for discussion during budget deliberations.

In balancing the *Proposed FY 2004 Budget* a number of decisions were made. They included:

Expenditure Adjustments

- A reduction to General Government requests (\$900,000)
- A reduction to the Fleet Replacement Transfer request (\$100,000)
- A reduction to the proposed Reserve for Economic Development (\$250,000)
- A recommendation to utilize General Fund reserves to finance pay-as-you-go capital projects (\$1.9 million)
- Adjustments to debt service assumptions and the timing of the issuance of new debt (\$2 million)
- Increased dependence on the Managed Vacancy Program to identify and isolate savings (\$309,000)
- A reduction of the preliminary General Fund transfer to the Solid Waste Fund (\$170,000)
- A recommendation to not fund a number of requested new positions (\$308,000) and the elimination of others (\$118,000)
- A recommendation to provide a two percent (2%) general salary increase for City employees (\$900,000 cost) and school employees (\$970,000 cost)

Revenue Adjustments

Various reductions and additions to preliminary revenue estimates resulted in a net reduction of approximately \$300,000. In order to fund the proposed salary increase for both City and school employees, it is proposed that the local tobacco tax be increased from fifteen cents (\$0.15) to forty-five cents (\$0.45) per pack. This action will produce approximately \$1 million.

Use of Fund Balance

Prudent fiscal management has allowed the balance in the General Fund to exceed the target of ten percent (10%) of revenues, currently approaching fourteen percent (14%). The proposed budget recommends utilizing \$1.9 million for pay-as-you-go capital outlay and setting aside \$750,000 in dedicated reserves. Nevertheless, it is recommended that, given fiscal uncertainties, for the upcoming fiscal year, fund balance reserves should be maintained at twelve percent (12%) of revenues. This is reflected in the proposed budget and will result in a projected General Fund Balance on June 30, 2004 that will be approximately \$2.5 million more than the policy target. These funds can provide a buffer against further state revenue reductions and a continuing national recession or, they can give City Council a measure of flexibility as it deliberates the *Proposed FY 2004 Budget*. One caveat must be kept in mind. The *Proposed FY 2004 Budget* complies with the financial management policy of matching ongoing expenditures with annual revenues. Utilizing fund balance to cover recurring costs is inconsistent with the financial management policies and would require actions to either increase revenues or reduce recurring expenditures in subsequent years.



The Budget Document

Unlike previous budgets, a concerted effort has been made to include in this document a complete description of the resources received by the City from all sources and their uses. In particular, the budget shows grant revenues and associated expenditures in the various departments. Furthermore, all of the various funds utilized by the City are shown along with their proposed revenues and expenditures and balances. An effort has also been made to eliminate certain funds that no longer serve a useful purpose such as the Donations Special Revenue Fund, the Partners in Emergency Response (PIER) Fund, the Operation-Plant-a-Tree Fund, the Recycling Fund and the Title XX Operating Fund. One new fund, the Stadium Fund, was created to manage revenues and expenditures related to operations and debt service at the renovated City Stadium.

Major categories within the General Fund are grouped in accordance with guidance provided by the State Auditor of Public Accounts for comparative cost reporting. New to this document is that Parks & Recreation is represented as an independent department, no longer a part of Human Services, and the Customer Service function has been included under Communications & Marketing. Several department budgets that were previously presented as a collection of separate sub-departments have been consolidated. The budget document also includes organization charts for each department/division that show which positions are supported by local revenues and which are supported by other means such as federal or state aid or grants. Finally, under each General Fund department is a comparison of the Managers' recommendation for FY 2004 to the *Adopted FY 2003 Budget* and a listing of major items requested by the department but not recommended for funding.

General Fund Revenues

Total General Fund revenues for FY 2004 are projected to be \$119.6 million, representing an increase of \$1.9 million or 1.6% above the *Adopted FY 2003 Budget*. General Fund revenues consist of both Dedicated Revenues (\$22.5 million) and Non-dedicated revenues (\$97.1 million).

Dedicated Revenues

Dedicated revenues are those revenues that are specifically designated by the Federal, State or City government to be used for specific programs. Overall, dedicated revenues are projected to decrease \$1.6 million or nearly seven percent (6.8%). This is the clearest evidence of the reduction in state funding due to the fiscal crisis. The projections may have to be further adjusted after finalization of the state budget. Decreases will be seen in support for constitutional officers, juvenile programs, social services, aid to libraries, and state grant funding. One area of increase, that will accrue to the Airport Fund, will be a reimbursement from the Transportation Security Administration for security at the regional airport.



Non-Dedicated Revenues

Non-dedicated revenues, or those revenues that can be used at the City's discretion, are projected to increase approximately \$3.5 million from the *Adopted FY 2003 Budget*. The increase comes from increased property taxes, a modest increase in the meals tax, and a proposed increase in the tobacco tax.

Over eighty percent (82%) of non-dedicated revenues and over sixty-five percent (66.3%) of total General Fund revenues are generated by six local taxes, the Real Property Tax (\$32.5 million), the Personal Property Tax (\$16 million, including the state reimbursement), the Local Sales Tax (\$11.1 million), the Meals Tax (\$7.4 million), the Business License Tax (\$5.9 million), and Consumer Utility Taxes (\$6.5 million). Other than the property taxes, these revenue sources are especially responsive to economic conditions.

General Property Taxes

Real Property Tax revenues are projected to increase by approximately \$1.9 million, or about six percent (6%). Real Property Tax revenue projections are adjusted for a historically uncollectable percentage two percent (2%), tax relief for the elderly (\$500,000) and rehabilitation tax credits (\$300,000). For budgetary discussions, each penny on the Real Property tax rate of \$1.11 will generate approximately \$280,000. This revenue source represents one-third (33.6%) of General Fund non-dedicated revenues.

The Assessor's Office is currently completing the biennial reassessment of real property which will take effect on July 1, 2003. Notices to property owners will go out in August. At this point, it is projected that the total assessed value of real property in the City will increase six percent (6%) to nearly three billion dollars (\$2,994,405,750). Excluding new construction and corrections to assessment records, the total assessed value will grow by three percent (3%). Adjusting the Real Property Tax rate to produce the same amount of revenue as during FY 2003 would require a reduction from \$1.11 to \$1.08 per hundred dollars of assessed value. Such a reduction, which is not recommended in this budget, would require an adjustment of approximately \$900,000 to estimated revenues for FY 2004. Council will be required to hold a public hearing on the effective tax increase prior to preparation of the first tax bills.

Personal Property Tax revenues are projected to increase slightly, by approximately \$478,000 or 3.0% to \$16 million. This includes the state reimbursement for 70% of the tax on private vehicles. Growth in Personal Property, Business Property and Machinery & Tools assessments in the coming year is estimated to be two percent (2%). Of note is that FY 2004 will be the first year that the City will receive machinery and tools tax from Frito-Lay. The Personal Property Tax category represents nearly seventeen percent (16.7%) of General Fund non-dedicated revenues.

Public Service Corporations Tax revenue is projected to increase approximately \$200,000 or nearly nine percent (9.1%) to \$2.5 million. This revenue is assessed by the State.

Other Local Taxes

Local Sales Tax revenue is the third largest portion of non-dedicated revenues to the City, nearly twelve percent (11.4%) of those funds. This is a revenue source that responds to economic conditions and it has shown small losses over the last several years. Projections indicate a slight reduction of approximately \$150,000 from the *Adopted FY 2003 Budget*, to \$11.1 million.



Consumer Utility Tax revenues are projected to increase slightly, by approximately \$90,000 from FY 2003, to \$6.5 million.

Fortunately, **Meals Tax** revenues have not followed the downward trend of the Local Sales Tax. With several new restaurants opening in the City and others planned, this revenue may increase as the recession weakens. The revenue estimate of \$7.4 million represents over seven percent (7.7%) of General Fund non-dedicated revenues and is projected to grow approximately four percent (4.9%) from the current year.

Business License Tax revenues of \$5.9 million reflect a loss of \$400,000, or a little over six percent (6.8%) from the current year. This source makes up about six percent (6.1%) of General Fund non-dedicated revenues. Although continued sluggish business activity affects these revenues, the most significant loss is the expiration of an annual \$300,000 payment in lieu of taxes from Centra Health. Negotiations regarding the continuation of this payment will take place in the spring.

Other taxes in this category make up approximately \$6.9 million of the FY 2004 revenue stream, an increase of \$1.3 million from the current year. This category includes **Right of Way Fees** (\$320,000), **Cable Franchise License Fees** (\$550,000), **Electricity and Gas Consumption Taxes** (\$320,000), **Motor Vehicle Licenses** (\$1.3 million), **Bank Stock Taxes** (\$1.1 million), **Recordation Taxes** (\$290,000), **Tobacco Taxes** (\$1.5 million), the **Amusement Tax** (\$280,000), and the **Transient Occupancy and Lodging Tax** (\$1.3 million). Other than the Tobacco Tax, for which a rate increase is proposed, most of these revenues are expected to show little change from FY 2003 to FY 2004. Overall, the Other Local Taxes category will increase \$1.2 million if the increase in the Tobacco Tax, which will generate \$1 million, is approved.

Permits, Fees, and Licenses are projected to increase by approximately \$175,000, reflecting increased fee revenue for building permits and plan review, **Charges for Services** are projected to generate \$1.3 million, basically unchanged from FY 2003.

Other revenue sources are projected to fall slightly in FY 2004. Of significance is **Interest on Investments**, down \$400,000 to \$300,000, reflecting universally lower interest rates, and **Non-Categorical State Aid**, down \$200,000.

General Fund Expenditures

Proposed General Fund expenditures of \$119.6 million represent an increase of \$2.4 million or two percent (2.03%) over the *Adopted FY 2003 Budget*. The General Fund finances all government activities with the exception of the Airport, Solid Waste, Water, and Sewer operations. All funds contribute to the operations of the Fleet Internal Services Fund. A comparison of each of the General Fund operating departments as a percentage of total General Fund expenditures demonstrates the impact of these service areas on the entire proposed spending plan.

**Expenditures as a Percent of Total General Fund Expenditures**

	Proposed FY 2004 General Fund Expenditures	Percent of General Fund
General Government	\$9,302,877	7.8%
Judicial Administration	3,260,831	2.7%
Public Safety	22,919,471	19.1%
Public Works	12,881,960	10.8%
Health and Welfare	12,743,705	10.6%
Parks, Recreation and Cultural	3,778,349	3.2%
Community Planning and Development	2,152,781	1.8%
Civic, Community and Regional Organizations	6,074,856	5.1%
Non-departmental	3,210,087	2.7%
Transfers	36,620,207	30.6%
Reserves	1,700,000	1.4%
Debt Service	4,975,256	4.2%
TOTAL GENERAL FUND	\$119,620,380	100%

General Government includes Council/Manager Offices, City Attorney, Budget, City Assessor, Commissioner of the Revenue, Communications & Marketing, Financial Services, Human Resources, Information Technology, Internal Audit, Electoral Board, Registrar and Treasurer. **Judicial Administration** includes the Circuit, District and Juvenile and Domestic Relations Courts, the Clerk of the Circuit Court, Commonwealth's Attorney, Magistrates Office, Sheriff and Court Services Unit. **Public Safety** includes the Police Department, the Fire and EMS Department, the Animal Warden, and Emergency Communications. **Public Works** includes Administration, Engineering, GIS, Buildings and Grounds, Snow and Ice Removal and the Streets and Division. **Health and Welfare** includes Human Services Administration Social Services and Juvenile Services. **Parks, Recreation and Cultural** includes Parks and Recreation, the Library, and Museum system. **Community Planning and Development** includes Planning, Neighborhood Services, Inspections, and Economic Development.

Civic, Community, and Regional Organizations are groups that provide services to the City outside of general government activities. While not all of the groups proposed for funding in this section are non-profits, many of them fall into this category. Funding for these organizations generally remains unchanged in the *Proposed FY 2004 Budget*.

Non-departmental includes those miscellaneous components of the City budget that generally do not fit nicely into an individual departmental budget but are widespread throughout, such as medical and dental costs and a general salary increase if programmed. **Transfers** include payments from the General Fund to other funds as a subsidy or payment for services.

Significant Expenditure Increases



There are few significant changes in the proposed budget from the current year. Of note are the following:

- A proposed two percent (2%) general salary increase for City employees (\$900,000)
- Funding to cover an anticipated ten percent (10%) increase in active employee health benefits (\$242,000)
- An increased transfer to Schools to fund a two percent (2%) salary increase (\$970,000)
- Increased prisoners and per diem cost at the Blue Ridge Regional Jail (\$600,000). This is primarily a result of a decrease in state per diem support for regional jails. Because Lynchburg is responsible for approximately fifty percent (50%) of the regional jail population, the impact of reduced state funding is significant.
- Funding for initiatives in Information Technology (\$185,000)

Local Contribution to City Schools

At the time of preparation of this proposal, the Lynchburg City Schools had not yet forwarded a request for local funding in FY 2004. Although declining enrollment is expected to continue, the *Proposed FY 2004 Budget* maintains the local contribution for schools at the same level as the current year, and, in addition, provides an increased contribution of \$970,000 to fund a two percent (2%) salary increase for school employees. School Debt Service will increase by \$400,000, from \$4.4 million to \$4.8 million. Funding in an amount of \$32.9 million is proposed for school operations and debt service. With a projected decline in enrollment of 107 students, local per student support will increase from \$3,551 to \$3,753.

Capital Construction

Ideally, a portion of the Capital Improvement Program should be funded each year on a “pay as you go” basis. Beginning in FY 2001, a portion of the fund balance above the targeted ten percent (10%) of General Fund Revenues was allocated to pay-as-you-go capital construction for those smaller projects and/or projects that have a life of less than 20 years. The *Proposed FY 2004 Budget* provides \$1.9 million from the General Fund balance for capital construction compared to approximately \$1.2 million in FY 2003. Projects proposed for funding include:

Street & Utility Extensions for Economic Development	\$200,000
General Development Support for Economic Development	\$100,000
Major Building Repairs and Roof Replacement	\$960,000
Transportation Activities	\$370,000
Central Virginia Community College Site Work	\$100,000
Parks & Recreation Projects	\$200,000

Debt Service



The City finances a large component of the Capital Improvement Program (CIP) with general obligation bonds. Schools debt service is increasing from \$4.4 million to \$4.8 million and City debt service is decreasing from \$5.6 million to \$5.0 million for a net decrease of \$200,000. Two factors affect the decline in City debt service. First, debt service requirements for FY 2004 were reduced from \$13.9 million programmed into the *Adopted FY 2003 Budget* to \$8.5 million. Second, the City will realize a savings on additional debt service of approximately \$250,000 in FY 2004 as a result of the refinancing of \$24 million of existing debt this spring.

The FY 2004-2009 CIP anticipates the issuance of \$15.7 million in bonds to fund capital expenditures for General Government and Lynchburg Public Schools during FY 2004. The largest of those projects will be renovations to E.C. Glass High School, a project that is expected to take three years at a cost of over \$25 million. Other projects supported by bonds include renovations to Monument Terrace and the Old Courthouse/Museum, major transportation improvements and projects for Parks & Recreation. Due to the timing of the FY 2004 bond issue, only one interest payment of \$350,000 will be due on the new debt in FY 2004, however, FY 2005 debt service will increase by \$1.0 million as a result of the FY 2004 bond issue. FY 2004 debt service as a percent of operating expenditures is projected at eight percent (8.13%), well within the ten percent (10%) target.

Reserves

The *Proposed FY 2004 Budget* includes reserves set aside to address capital projects and contingencies.

Reserve for Economic Development	\$250,000
Reserve for Snow, Streets and Bridges	\$500,000
Reserve for Downtown Development	\$500,000
General Fund Reserve for Contingencies	\$1,200,000

In 2002 City Council repealed an ordinance that established a formula for funding a Reserve for Strategic Initiatives based on growth in revenues. Due to minimal revenue growth and fiscal constraints the formula was no longer viable. Nevertheless, the dedication of reserve funds for economic development activities is important for business recruitment, retention, and expansion. Funding in the amount of \$250,000 is proposed as a Reserve for Economic Development.

The Reserve for Snow, Streets and Bridges serves as a contingency should the costs of snow removal exceed budgeted resources. Unused funds are subsequently transferred to the Capital Fund for pay-as-you-go financing of street and bridge projects. Funding in the amount of \$500,000 is proposed for this reserve, with \$250,000 allocated from General Fund revenues and \$250,000 allocated from available fund balance.

The City has committed to support the private development of 67 market rate loft apartments and 12,500 square feet of commercial space in the old James T. Davis, Piggly Wiggly, and tobacco warehouse buildings in the 1200 block of Main Street. The Reserve for Downtown Development includes \$500,000, one half of the amount that will be required after the buildings are renovated in 2004. The \$500,000 is available from fund balance in excess of the twelve percent (12%) target.



The General Fund Reserve for Contingencies funds expenditures during the fiscal year that were unanticipated during budget development. Any funds remaining in this reserve at the end of the fiscal year revert to the General Fund Balance. The Financial Management Policies establish a goal of \$1.2 million for this reserve. The *Proposed FY 2004 Budget* meets this goal.

As in FY 2003, a Reserve for Health Insurance in the amount of \$195,000 is budgeted in Departmental Operating Expenditures. This reserve will be used in the event that health insurance claims exceed budgeted funds.

Undesignated General Fund Balance

Proposed expenditures, transfers and reserves of \$122.3 million exceed annual revenues of \$119.6 million by \$2.7 million. Consistent with City Council's policy, fund balance in excess of the ten percent (10%) target can be used for pay-as-you-go capital expenditures, other non-recurring expenditures or as additions to fund balance. The *Proposed FY 2004 Budget* includes \$2.7 million for pay-as-you-go capital financing and reserves as described above.

The City's Financial Management Policies call for an Undesignated General Fund Balance to be "maintained at a level to provide the City with sufficient working capital and a comfortable margin of safety to address emergencies and unexpected declines in revenue without borrowing." A minimum balance of seven percent (7%) of General Fund revenues with a target of ten percent (10%) is stipulated. For the Proposed FY 2004 Budget an Undesignated General Fund Balance at twelve percent (12%) of revenues is recommended. The fund balance at the end of FY 2004 is anticipated to be \$14.4 million, or \$2.4 million beyond the stipulated target.

Personnel

As with any service organization, the largest part of the City's operating budget is devoted to employee compensation through wages, salaries and benefits. City Council understands the value of competitive employee compensation in recruiting and retaining a qualified, competent and diverse workforce capable of maintaining excellent core services. The City continues efforts to promote workforce stability and has experienced acceptable voluntary turnover rates and positive recruiting experience for most vacant positions. A notable exception has been higher than usual turnover in the Police Department over the last year. Some of the losses are attributable to increased federal employment opportunities and the hiring of security officers at BWX Technologies at attractive salaries.

The foundation of the City's compensation plan rests on the goal of attracting and retaining employees that are qualified, competent and representative of the community through pay ranges anchored by midpoints that closely match the average pay in the relevant labor market. To measure the competitiveness of the pay structure, the Human Resources Department conducts periodic surveys of selected benchmark positions and compares pay ranges and average employee pay to calculated market averages. Past results have indicated that the City's overall pay structure, as reflected by its published pay ranges, is competitive with comparable organizations and is reflective of Council's prior actions in support of the pay philosophy. The *Proposed FY*



2004 Budget includes minor funding to make adjustments to specific positions where market comparisons and analysis of turnover and recruitment experience indicate the need for such adjustments.

While competitive pay ranges are vital to the recruitment of a qualified workforce, actual employee pay is also critical for retaining good employees to maintain high performance and productivity. Market analysis has indicated that the overall average pay for City employees is approximately fifteen percent (15%) below the average pay for similar jobs in the relevant labor market. While the pay for some positions remains competitive with respect to market, more and more are falling below market. In addition, the practice of adjusting pay ranges without corresponding increases in actual pay for individual employees has resulted in a compression of pay at the lower end of the ranges, particularly with positions having a large number of incumbents such as in the police and fire departments. These issues are becoming increasingly problematic and could result in higher turnover unless addressed in the near future. The proposed two percent (2%) salary increase for City employees, at best, maintains the relative disparity between City employee pay and the market.

The City continues to experience rising health benefit costs due to increasing membership and industry-wide increases in medical and dental services as well as prescription drugs. It is projected that a ten to twelve percent (10-12%) increase in funding for active employees will be required at a cost of \$242,000. Funding for the increase is included in the *Proposed FY 2004 Budget* without making plan changes and shifting costs to employees as was done in the current year. The enterprise funds will also see proportional increases. In addition, costs for retiree medical and dental benefits are expected to rise approximately \$110,000. We will continue to maintain a Health Insurance Reserve of \$195,000 to buffer unexpected costs

Eight (8) new full time positions were requested by General Fund departments: five (5) Police Officers, a Programmer/Analyst for the Fire Department, a Business Development Manager for Economic Development, and, a Recreation Services Manager for Parks & Recreation. Of those, only the position in Economic Development is recommended at this time, although further discussion of the other positions is warranted. In addition, the *Proposed FY 2004 Budget* supports the conversion of two wage positions in Financial Services to a full time Account Technician II position (at a cost savings) and, making the Environmental Planner in the Department of Community Planning and Development a full time, in-house position. Currently, that position provides part-time assistance through a contribution to the Soil and Water Conservation District that will be reduced.

The FY 2004 budget will also include two (2) Lead Program positions, supported by a Federal grant, a Plan Reviewer supported by fee revenue, an Account Technician and File Management Specialist in Billings and Collections supported by the Solid Waste Management Fund, and four (4) Police Officers for airport security with costs reimbursed by the Transportation Security Administration. All nine (9) positions were approved during the current fiscal year.

Positions will be eliminated in Community Planning and Development (Strategic Planner), Public Works (Financial Administrator) and Social Services (2 Benefits Programs Specialists). Previously approved positions will remain vacant in the City Manager's Office, the Commissioner of the Revenue and the Clerk of the Circuit Court.

With these proposed adjustments, the City's workforce would total 1321.24 employees. This includes 1,160.00 full-time classified, 42.74 part-time classified, 43.50 grant positions and 75.00 state positions



New Initiatives

The *Proposed FY 2004 Budget* is short of significant new initiatives. The following are of note:

- Four Information Technology projects will advance the City's Information Technology Strategic Plan. The City's current Personal Property Tax System, developed in-house and expensive to maintain, will be replaced with a commercial, off-the-shelf product. The City's Imaging System will be expanded to improve productivity and customer service in the Human Resources Department, the Fire Department, and the City Attorney's Office. The Permits and Inspections System will be enhanced to make the system mobile and allow building inspectors to use it in the field. Finally, an out-dated work management system serving Public Works will be replaced. This will be a two-year effort, with the first phase, the definition of system requirements, occurring in FY 2004. Resources from the General, Water, Sewer, and Solid Waste funds will be combined for this effort.
- Funding has been included for Communications & Marketing to establish a Citizen's Academy to promote citizen education, volunteerism and service on various boards and commissions. Communications & Marketing will be asked to provide coordination of volunteer opportunities with the City. The department will also be involved in a major redesign of the City's web pages to allow better access for citizens to information and services.
- The establishment of a Master Firefighter designation in the Fire Department (pending identification of funding)
- Certification pay for firefighters possessing special qualifications (pending identification of funding)
- Weaning of the Department of Community Development and Planning from using Community Development Block Grant (CDBG) funds to support positions. This will start a multi-year process to stop using CDBG funds for ongoing operating costs.

Fleet Services Fund

Beginning in FY 2001, an Internal Services Fund was created to manage the City's fleet of over 600 vehicles and equipment. The Fleet Services Manager reports to a Board of Directors consisting of representatives from various departments that utilize fleet services. FY 2002 was Fleet Services' first full year of operations in new garage facilities. The total operating budget of \$4.0 million for Fleet Services is a decrease of seven percent (7.3%) percent from FY 2003, primarily as a result of savings in supplies, utilities and vehicle purchases.

Annually, Fleet Services, in consultation with each department, determines the most efficient fleet replacement program for the next year based on actual miles driven and maintenance costs. A General Fund transfer of \$657,000 is provided for fleet replacement in FY 2004. This represents an increase from the



\$623,000 provided in FY 2003. Due to fiscal constraints, an equipment depreciation component has not been factored into the annual charges to departments for fleet replacement.

Capital Fund

The *Proposed FY 2004-2009 Capital Improvements Program* includes \$40.5 million for general capital projects and \$47.1 million for school capital projects. Adoption of the program is anticipated coincident with adoption of the annual budget. Major projects proposed for funding in FY 2004 include the addition to and renovation of E.C. Glass High School, Monument Terrace renovations, Old Courthouse/Museum renovations, Atherholt Road extension, Major Bridge Repairs, Street Overlay projects (previously in the operating budget), Downtown/Riverfront Improvements, City Stadium renovations, various Parks and Recreation improvements as well as Roof Replacements and Major Building Repairs. In all, capital project costs will total approximately \$22.3 million in FY 2004.

Airport Fund

The Lynchburg Regional Airport is budgeted as a separate fund to clearly delineate its financial operation and the support from the General Fund. Cost Center revenues and a General Fund subsidy of approximately \$648,000 cover total expenditures of \$2.2 million. In spite of the many challenges faced by the airport due to the loss of air service and heightened security concerns, the subsidy for FY 2004 is actually projected to decrease by about \$83,000. FY 2004 operating expenditures are projected to be basically unchanged from the current year. Although the airport is experiencing additional costs for security provided by the Lynchburg Police Department, the federal government provides a reimbursement.

Water Fund

The City's water system can be characterized as having low rates and ample capacity, positioned for significant growth opportunities in its customer base. In addition to serving approximately 20,500 City accounts, water is sold by contract to the counties of Amherst, Bedford and Campbell and to several large industrial customers (Rock-Tenn, Frito-Lay and Griffin Pipe). The Water Fund operates as an enterprise fund and requires no subsidy from the General Fund.

Water Fund total revenues are projected to increase by \$700,000, from \$8.2 million to \$8.9 million, while expenditures will increase to \$9.1 million. The difference will be made up from existing funds. The addition of one position, a Cross Connection Inspector, is recommended. Revenues from Charges for Services are expected to increase from \$6.3 million to \$6.9 million with the implementation of a proposed rate increase averaging about ten percent (9.5%) for larger commercial customers. It is also anticipated that revenues from water contracts with large users will increase by approximately \$200,000.

The FY 2004 utility rate study proposes no increase in the Water Block 1 rate, charged primarily to residential customers, but the rates for Block 2 and 3, which include commercial, institutional and industrial customers, are proposed to increase ten percent (10.0%) and twenty-one percent (21.3%) respectively. The City's goal for over ten years has been to eliminate the water block rate structure and have a single water



volume rate for all non-contract customers. Progress in meeting this goal has been slight and the proposed increases in FY 2004 will eliminate the Block 3 rate and will move the Block 2 rate toward elimination within two years.

With the rate increase recommended by the City's utility rate consultant, PJ Sun LLC, the fund balance is projected to be fifty-two percent (52%) of total fund expenditures for FY 2004 with a debt coverage ratio of 1.39, in compliance with City Council's policy to maintain a fund balance at forty percent (40%) of annual fund expenses and a debt coverage ratio of no less than 1.2.

Sewer Fund

The City's sewer system serves Lynchburg and portions of the surrounding counties. Although operated by the City, the wastewater treatment plant is a regional asset with capital costs shared by the localities proportionally. The City has contracts with several large industrial users (Rock-Tenn, Frito-Lay, Griffin Pipe and Westover Dairy). The Sewer Fund is also operated as an enterprise fund and requires no subsidy from the General Fund.

The *Proposed FY 2004 Budget* projects revenues of \$14.9 million against expenses of \$14.7 million which will reverse a recent trend of utilizing the fund balance to close the gap between revenues and expenditures. Revenues are projected to decrease slightly (\$100,000) and expenditures are projected to decrease \$800,000, or five percent (5.2%) from the current budget. The net revenue increase is a combination of an actual loss of approximately \$500,000 in revenue from large industrial users and a proposed rate increase of almost nine percent (8.6%). The level of rate increase is intended to maintain the fund balance and debt coverage ratio at levels that ensure compliance with a Special Order between the City and the Department of Environmental Quality (DEQ) for the correction of Combined Sewer Overflows (CSO) and to provide for operating and debt service costs.

The combined effect of proposed rate increases in both the water and sewer funds is anticipated to be about five and one half percent (5.5%) on the average customer's monthly bill.

The special order with DEQ establishes a compliance schedule and project priorities for implementation of the CSO control plan. Although the City has spent over \$134 million on CSO control since 1993, the estimate to complete remaining necessary work is over \$200 million. The compliance schedule does not contain fixed dates for implementing the CSO control plan, but rather provides for implementation based on three criteria that reflect the limits of the City's financial capability. These criteria are:

1. The City is required to maintain rates so that the annual sewer bill for the average residential customer, using 9 hundred cubic feet (hcf) a month, equals or exceeds 1.25% of median household income (MHI).
2. The City is required to maintain a sewer operating debt coverage ratio within a range of 1.15 to 1.5.
3. The City is required to have reserve funds equal to no more than 25% of the prior year's budgeted operating expenditures.



With the rate increase recommended by the City's utility rate consultant, PJ Sun LLC, the fund balance is projected to be 25% of fund expenses for FY 2004, with a debt coverage ratio of 1.21, therefore meeting the criteria defined by DEQ. Based on 2000 Census data, the annual sewer bill for the average residential customer is estimated to be 1.41% of median household income.

While expenditures for sludge disposal and operation of the new odor control facility are increasing, savings have been realized in other areas to result in a net reduction. One Utility Operator position is proposed for elimination in FY 2004.

Due to the fiscal challenges facing the Sewer Fund, even after a rate increase, there is little capacity for starting new capital projects. The lack of state matching funds for CSO work will also have an impact on the City's ability to utilize federal grants.

Solid Waste Management Fund

The Solid Waste Management Fund is established as an enterprise fund. The fund assesses solid waste disposal costs through a tipping fee at the landfill and a decal and tag system for residential collection. Collection costs are covered through a General Fund Transfer and, for a number of years, the fund has been using fund balance to close a gap between revenues and expenditures. A rate study conducted by Reed, Stowe and Yanke during the summer of 2002 recommended rate increases across the board. City Council increased tire disposal, sludge disposal and commercial rates on August 1, 2002 and entered into a lengthy discussion regarding residential rates. Basically, the residential rates needed to at least double to eliminate dependence on fund balance reserves. Three public meetings were held in September to receive citizen input. At those meetings there was a strong message that citizens wanted to continue the practice of paying based on the amount of trash they produced for disposal. City Council was also concerned, however, with the large number of residences exempt from paying for collection and disposal services and several other services, such as litter control, illegal dumping response, and brush and bulk collection that serve all citizens regardless of the amount of waste individually produced. In the end, City Council decided to establish a monthly fee of \$5.00 per household while the costs of decals and tags were kept the same. City Council also decided to change the method of residential refuse collection from a manual system to semi-automatic collection. Although final action by City Council is still pending, the residential rate increase is anticipated to take place by January 1, 2004. These actions should place the Solid Waste Management Fund on a sound financial footing for the foreseeable future.

FY 2004 revenues are projected to be \$7.1 million against expenses of \$6.5 million. This reverses the past situation where revenues did not cover expenses and is a direct result of the proposed implementation of the flat fee for solid waste management services.

In August 1999, City Council adopted financial policies that established a debt coverage ratio of no less than 1.2 and fund balance targets of 40% of annual fund expenses for enterprise funds. The *Proposed FY 2004 Budget* will meet the debt coverage ratio target. It is projected that the debt coverage ratio will be 1.96 with the proposed fee structure. The fund balance is projected to be at sixty-three percent (63%) of expenses or \$3.8 million, strengthened by the proposed fee increase and a recalculation of the required reserve for closure that returned \$777,240 to the fund balance.



Outstanding Issues

There are a number of outstanding issues that may impact the budget deliberations or that will require discussion during the process.

- The General Assembly's adoption of amendments to the biennial budget could result in further cuts in state funding to localities and further mandates for local spending. Reductions to Constitutional Officers, public education, human services and public safety, will either require difficult decisions about service delivery or the shifting of resources from other areas of the budget.
- Council must take final action to enact the user fee increase to support the Solid Waste Management Fund.
- Discussions with Centra Health regarding the payment in lieu of taxes agreement which expires on June 30, 2003 could result in additional revenue.
- There are a number of positions requested but not proposed in this budget that should be considered once there is a better understanding of their responsibilities and value. They include five (5) Police Officers, a Programmer/Analyst for the Fire Department and a Recreational Services Manager in the Parks & Recreation Department.
- The regional health insurance consortium will receive bids this spring that could result in a lower increase in premiums than currently anticipated. Participating with the consortium would require switching to another health insurance program administrator and significant communication with employees.
- There is a strong interest in identifying resources to support the establishment of a Master Firefighter designation and to provide for certification pay in the Fire Department.
- Both Community Development Block Grant (CDBG) and General Fund resources have been programmed to support Spot Blight activities through the Lynchburg Redevelopment and Housing Authority and demolition and repairs by the Inspections Division of the Department of Community Development and Planning. These activities are interrelated and I am concerned that there may be more funding than is necessary. An analysis of past allocations, current resources and future plans should be conducted to verify that designated resources are appropriate to support planned activities.
- As the work of the Safe Neighborhoods Task Force proceeds, additional resources may be desired to support proposed initiatives.
- Fuel prices will need to be revisited prior to budget adoption and throughout FY 2004 due to market volatility.



Outlook

The City of Lynchburg will continue to meet the challenges of national recession, state fiscal crisis, and increasing demands for costlier services. The City will maintain its focus on public safety, education, core services, safe neighborhoods, downtown development and redevelopment, infrastructure maintenance and broad based economic development.

As an older central city, Lynchburg faces many fiscal issues and it has responded well in many areas. One continuing and significant constraint is the state budget situation. Cities are tools of the state for the delivery of essential services such as public education and social services. That relationship is manifested in the many mandates placed on local governments. In the past, there was a greater sense of partnership between the state and its localities. Today, that relationship is strained by a fundamental imbalance between revenues and necessary expenditures. The state has addressed its fiscal crisis, in part, by shifting more of the burden for funding state-mandated services to the localities and through one time fixes that cannot be repeated in subsequent years. Without unprecedented economic recovery and growth, crafting a state budget for the next biennium will be the most challenging in recent history. Just to close the current \$1.7 billion structural deficit in the state budget will take economic growth of five percent (5%) and that will not accommodate any spending increases, many of which, such as Medicaid, are mandatory.

One example will demonstrate the unbalanced partnership between the state and local government. The General Assembly has approved budget amendments for FY 2004 to provide a two and one quarter percent (2.25%) salary increase for the state's teachers. One third, or \$8 million, of the cost will come from growth in lottery proceeds that were already due to localities by statute. In addition, the budget language doesn't provide funding until January 1, 2004 and then only if certain optimistic revenue projections are realized. The reality for localities is that teacher salary increases typically apply to the contract year and contracts are signed in the early summer. Therefore, localities have to plan for a full year of the costs of a salary increase. Furthermore, once the funding formulas, the Standards of Quality and the Composite Index, are applied, the state will fund only a small portion of the increase. While much will be made of the General Assembly's commitment to education, the reality for Lynchburg will be that funding of only about \$155,000 will be provided for a salary increase that will cost over \$1 million. If the General Assembly fully funded its constitutionally and statutorily established responsibility for public education, as determined by a recent study of the Joint Legislative and Audit Review Commission (JLARC), Lynchburg would receive approximately \$9 million more in state aid for education.

The time is well upon the Commonwealth for there to be a serious and honest examination of the respective responsibilities of the state and local governments in providing services to citizens and the means by which to pay for them. Tax restructuring is long overdue. Lynchburg will continue to work with the Virginia First Cities Coalition and the Virginia Municipal League to address the structural inadequacies in the Commonwealth's governmental and tax structure.

In the meantime, the City will continue to exercise fiscal prudence through adherence with the adopted financial policies and conscientious examinations of spending patterns and opportunities for savings. The "Seek Out Savings" program, initiated to help cope with reductions in state funding, will move into its implementation stage as the many suggestions received from employees are narrowed to focus on those holding the most promise for savings and greater efficiency in service delivery. In addition, the following initiatives should be considered to improve overall fiscal management:



- long range projections (4 to 5 years out) of revenues and expenditures discussed with Council in advance of budget development
- a biennial budget to more closely align with the state budget cycle and to better illustrate the impact of budget decisions on subsequent years
- the annual reassessment of real property to more closely track market trends
- greater collaboration with City schools in the areas of procurement, facilities management and support services
- continued development of performance measurements based on defined standards of service

Greater involvement of the citizens is also called for as we address many issues and strive to have the City remain a great place to live, work, play and visit. In the next year, the City will host its first Citizens Academy in an effort to further engage individuals in understanding and becoming active participants in their local government. Offered over a period of several months, the Citizens Academy will provide an overview of City operations and services with a goal of educating participants so that they may become actively involved through service on boards and commissions or in other ways, including elected or appointed office. We will also be exploring the feasibility of adding the coordination of volunteer resources to the responsibilities of the Customer Service office.

A source of growing pride is the great strides that are being made in downtown redevelopment. In spite of difficult economic times, many projects are underway. The Riverviews loft/commercial/art space project is under construction and leasing. There is the promise of further cultural opportunities downtown as the Academy of Music and the Fine Arts Center explore a merger that will consolidate their many activities in one location. The City's Human Services Department will occupy the newly renovated J.W. Ould building on Commerce Street, bringing about 200 employees downtown. Ninth Street and riverfront improvements are continuing and work to renovate the Old Courthouse/Museum and Monument Terrace will commence soon. Private investment is growing with the recent sale of the Wachovia Building, the initiation of the Bluffwalk hotel/ restaurant/brew pub complex, and the proposed development of several buildings near the Community Market for loft apartments and commercial space. Construction of a new Federal Courthouse and post office will start in the spring as the Lynchburg Redevelopment and Housing Authority occupies renovated space on Commerce Street. All of this activity positions the downtown to regain its prominence as the center of the region. A measure of the degree of success being experienced is greater concern about a lack of convenient parking downtown. Discussion regarding the construction of a parking deck will have to start in the near future.

Finally, I want to recognize the outstanding job done by the City's workforce. In the end, it is the City employees that put the annual budget into action for the benefit of Lynchburg's residents and visitors. Every day, they respond directly or indirectly to the citizens and for the last several years adjustments to their compensation have been minimal. To address that, work has started on the development of a citywide compensation philosophy to guide future decisions and to help to ensure that we keep the valuable employees that deliver important services. Our challenge is to find the resources to do this and we will explore opportunities for greater collaboration, efficiency and cost savings first.

Conclusion



The *Proposed FY 2004 Budget* is offered for City Council consideration, deliberation, amendment and adoption. In our judgement, it presents a balanced approach in a constrained and uncertain fiscal environment. This budget proposal remains a work-in-progress. Over the next several weeks, Council will have the opportunity to hear from and question the representatives of the various departments and agencies seeking funding in FY 2004. Work sessions will be held on Tuesday afternoons throughout the months of March and April. A public hearing on the proposed budget is scheduled for April 15, 2003, at 7:30 p.m., in Council Chambers. During Council's deliberations, staff is prepared to provide assistance and additional information as Council works towards budget adoption.

Copies of the *Proposed FY 2004 Budget* are available for public review at the main public library and the downtown branch as well as on the City's web site at www.lynchburgva.gov.

Acknowledgements

A number of City staff assisted in the development and production of the *Proposed FY 2004 Budget* and I would like to acknowledge their hard work. As she has for several years, Deputy City Manager Bonnie Svrcek provided outstanding leadership for the overall budget process. Donna Witt served as Acting Budget Director while continuing to carry out her responsibilities as Supervisor of Billings and Collections. All of the staff in Billings and Collections stepped up to help fill in. Kathy Scott and Kim-Chi To in the Budget Office were called on to do more in the absence of the Budget Director and they produced good work on tight schedules. Michael Hill, Financial Services Director, and Barbara Hudson, City Accountant, provided leadership and guidance in the development of the enterprise and other funds components. Financial Services accountants Missy Cunningham Bobbie Dalton, Robin Mamola, Amanda Smith, and Cindy Speck provided revenue projections, crunched numbers and balanced all of the City's funds. I am also particularly grateful for the extra effort contributed by a number of individuals who accepted the challenge of balancing their daily responsibilities with service as Budget Analysts. They included Christi Barnett, Sue Boyers, Greg Daniels, Tommy Doss, Peggy Ferrell, Bob Harvey, Lillian Lawrence, Pete Kelly and Dan Witt, all of whom are listed on the cover page.

Finally, I want to recognize the directors and staff of the various City departments who, in spite of considerable fiscal challenges, remain committed to delivering desired services to the citizens of Lynchburg in the most cost effective, efficient and equitable manner possible.



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